Congress of the United States
House of Representatives
Washington, DC 20515

December 10, 2002

Ambassador Robert Zoellick
Office of the U.S. Trade Representative
600 17th Street, N.W.
Washington, DC 20508

Under Secretary John Taylor
U.S. Treasury Department
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Ambassador Zoellick and Under Secretary Taylor:

We are writing to express deep concern over the U.S. position on capital controls in trade negotiations with Chile and Singapore. U.S. negotiators have reportedly been pushing aggressively for the elimination and prohibition of all capital controls under these bilateral agreements. This is a deeply misguided negotiating position. Not only is it bad for Chile, it is not helpful for the United States. We should be supportive of efforts to curb hot money, which can have a destabilizing effect on the global financial system.

Analysis of the Asian financial crisis of the late 1990s has pointed to the role of unstable short-term capital flows as a major cause. That is why even officials at the IMF, who had previously opposed controls, now agree that they can play a positive role in promoting financial stability. None of this is to suggest that capital controls are always implemented prudently or are without costs. But one does not need to support controls at all times and in all forms to recognize the importance of allowing their use as a macroeconomic tool to diminish the likelihood of financial crises.

It is particularly troubling that you would pursue capital control elimination in the Chilean negotiations. Chile used controls on capital inflows through much of the 1990s in a manner that has universally been viewed as restrained. In fact, Chile is viewed by many economists as a model for prudent use of controls.

Finally, we note the adverse consequences of using a bilateral trade agreement to pursue broad financial policy goals that go far beyond trade in their implications. A bilateral agreement on agricultural products or manufactured goods primarily affects the two parties to the agreement. But financial markets are fundamentally different from markets for other goods and services – global finance is far more fluid and far more indifferent to national borders. As a result, even a bilateral agreement on capital controls can quickly have global consequences.

We urge you to abandon the pursuit of capital control elimination in the Chile and Singapore trade agreements, as well as in future trade negotiations such as the FTAA.

Sincerely,

Barney Frank

BARNEY FRANK
Senior Member
Committee on Financial Services

Sander Levin

SANDER M. LEVIN
Ranking Member
Subcommittee on Trade
Committee on Ways & Means

Robert T. Matsui

ROBERT T. MATSUI
Senior Member
Committee on Ways & Means

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

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Barney Frank, M.C.
Washington, D.C.

December 19, 2002

The Honorable Barney Frank
United States House of Representatives
Washington, DC 20515

Dear Mr. Frank,

I am writing in response to your letter of December 10, regarding the U.S. position on capital controls in trade negotiations with Chile and Singapore. I share your view that the U.S. should negotiate Free Trade Agreements (FTAs) while ensuring economic development and stability of the signatory countries. However, I believe that we should negotiate FTAs without sacrificing the Trade Promotion Authority objective of "freeing the transfer of funds relating to investments." This objective is critical to the effectiveness of the investment and financial services chapters of the FTAs.

There is strong evidence that capital account liberalization is an important part of an economic development strategy. Access to foreign capital helps to broaden and deepen financial markets to mobilize capital more efficiently; broadens the array of lending available to domestic businesses; promotes large-scale investments that capture economies of scale; and stabilizes the local economy by spreading credit risk.

The U.S., Chile, and Singapore agree on the importance of free transfers and avoiding capital controls. The right of free transfers -- that is the right of an investor to transfer money freely into and out of a country -- is crucial to promoting foreign investment. Free transfers provide investors with a transparent regime for doing business free of exchange controls.

The U.S. position does not impair the ability of host countries to pursue domestic economic policies. Other adjustment mechanisms *are* consistent with free transfers, including: changes in reserves, interest rates, and exchange rates; and fiscal policy mechanisms. Both Chile and Singapore agree that sound macroeconomic policies and a strong, consistent regulatory environment are the preferred tools for both avoiding financial crises and for confronting them if they occur.

The U.S. has successfully negotiated forty–five Bilateral Investment Treaties (BITs) and two free trade agreements with investment provisions. These agreements have free transfer provisions.

On December 10, 2002, the U.S. and Chile reached a compromise with respect to transfers. This compromise both addresses Chile's concerns about preserving flexibility for dealing with capital flows and provides U.S. investors with substantially strengthened transfer rights. In this manner, the agreement signifies a "win-win" for both economies and should contribute to economic growth and stability in the respective countries.

Sincerely,

John Taylor

John B. Taylor
Under Secretary for International Affairs